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No. 90-1321

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In the Supreme Court of the United States

OCTOBER TERM, 1990

NATIONAL MEDICAL ENTERPRISES, INC.,
d/b/a THROUGH VARIOUS WHOLLY OWNED
HOSPITAL SUBSIDIARIES, PETITIONER

v.

LOUIS W. SULLIVAN,
SECRETARY OF HEALTH AND HUMAN SERVICES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals correctly refused to uphold, on collateral estoppel grounds, petitioner's challenge to the Secretary's disallowance of Medicare reimbursement for stock maintenance costs.

2. Whether the Secretary properly disallowed petitioner's claim for Medicare reimbursement for stock maintenance costs.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-15) is reported at 916 F.2d 542. The opinion of the district court (Pet. App. 16-23) is unreported.

JURISDICTION

The judgment of the court of appeals was entered October 10, 1990. A petition for rehearing was denied November 29, 1990. Pet. App. 55. The petition for a writ of certiorari was filed February 22, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Medicare program, the Secretary of Health and Human Services is required to reimburse "providers of service," *i.e.*, hospitals, for reasonable costs "necessary in the efficient delivery of needed health services" to Medicare patients. 42 U.S.C. 1395x(v)(1)(A). The Secretary's implementing regulations provide that to qualify for reimbursement, the provider's costs must be "necessary and proper," 42 C.F.R. 405.451(b) (1985), and "directly or indirectly related to patient care," 42 C.F.R. 405.451(c) (1985).[1] Since 1973, the Secretary has taken the position that under the governing statutory scheme,

> [t]he foliowing types of costs relevant to the proprietary and equity interest of the [provider's] stock holders, but not related to patient care, are excluded from allowable costs: costs incurred primarily for the benefit of stockholders or other investors, including but not limited to, the costs of stockholders' annual reports and newsletters, annual meetings, mailings of proxies, stock transfer agent fees, stock exchange registration fees, stock broker and investment analysis, and accounting and legal fees for consolidating statements for SEC purposes.

Pet. App. 6 (quoting Provider Reimbursement Manual § 2134.9 (1973)); see Pet. App. 6 n.1.

2. Petitioner owns acute care and convalescent hospitals. As a publicly held corporation, petitioner incurs a variety of so-called "stock maintentance

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[1] As the court of appeals pointed out, see Pet. App. 5, those regulations have recently been redesignated as 42 C.F.R. 413.9(b) and (c).

costs," namely, "stock transfer agent fees, stock and exchange registration fees and costs attributable to SEC filings, stockholder meetings, annual reports to stockholders, and institutional public relations related to stock and financial matters." Pet. App. 4. For a number of years, petitioner has tried to pass these costs through its separately incorporated hospitals and on to the Medicare program. The Secretary, however, has denied reimbursement.

In particular, petitioner and three of its subsidiary hospitals sought reimbursement for stock maintenance costs incurred during fiscal year 1973. The Secretary denied petitioner's claim, and petitioner sought review in the Claims Court. In 1986, the Claims Court reversed the Secretary's decision, holding that stock maintenance costs were subject to reimbursement under the Medicare program as reasonable expenses related to patient care. *National Medical Enterprises, Inc.* v. *United States*, 11 Cl. Ct. 329 (1986) (*NME I*); see Pet. App. 5.[2]

3. Thereafter, petitioner, on behalf of the three subsidiaries involved in the Claims Court litigation and fifteen additional subsidiaries, sought reimbursement for stock maintenance costs incurred during fiscal years 1974 through 1979. After an agency review process, the Secretary denied petitioner's claim. The Secretary held that "stock maintenance costs were incurred primarily for the benefit of present and future stockholders, not Medicare patients, and thus were not 'reasonable costs' related to patient care under the Medicare Act." Pet. App. 6. Moreover, the Secretary concluded that reimbursement was

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[2] *NME I* applied (11 Cl. Ct. at 332-333) Court of Claims precedent established by *AMI-Chanco, Inc.* v. *United States*, 576 F.2d 320 (1978).

unavailable in light of the governing Provider Reimbursement Manual § 2134.9 (1973).

Petitioner then filed this federal court action challenging the Secretary's denial of reimbursement.[3]

4. On cross-motions for summary judgment, the district court in June 1989 reversed the Secretary's decision. Pet. App. 16-23. The court determined that "[s]tock maintenance costs are necessarily incurred by providers in connection with equity financing. Such costs are indistinguishable from costs incurred by providers in connection with debt financings, * * * which are reimbursed by the Secretary." *Id.* at 22. The court concluded that "[t]here is no rational basis for disallowing the costs incurred by providers in connection with equity financings while allowing similar costs of debt financings." *Ibid.* Accordingly, the court held that "under the Medicare statute and regulations, stock maintenance costs must be allowed." *Ibid.*

5. The court of appeals reversed. Pet. App. 1-15. As a threshold matter, the court refused to hold that under the doctrine of collateral estoppel, the issue had been conclusively determined in petitioner's successful challenge to the Secretary's decision in *NME I*. The court concluded that the requisite "mutuality" was lacking, because "this lawsuit is grounded on

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[3] As the Claims Court pointed out in *NME I*,

> jurisdiction to review final decisions of the Provider Reimbursement Review Board or any reversal, affirmance, or modification by the Secretary, *for accounting periods ending on or after June 30, 1973*, rests with the district court for the federal district in which the provider is located or in the District Court for the District of Columbia.

11 Cl. Ct. at 332-333 n.4 (emphasis added); see 42 U.S.C. 1395oo note (1976).

the claims of eighteen-wholly owned subsidiaries—fifteen of which were not involved in the prior action." *Id.* at 8. As the court explained:

> Allowing a home office to establish mutuality merely by holding itself out as the "representative" of multiple subsidiaries would open the door for home offices with providers in multiple states to secure a favorable judgment in one circuit, then bind the government to that judgment in other circuits.

Id. at 9. Such a result, the court reasoned, would run counter to this Court's admonition in *United States* v. *Mendoza*, 464 U.S. 154, 160 (1984), that nonmutual collateral estoppel against the government "would substantially thwart the development of important questions of law by freezing the first final decision rendered on a particular legal issue." Pet. App. 9.

The court rejected petitioner's invitation to excuse the lack of mutuality on the ground that petitioner "and the fifteen subsidiaries that were not involved in [*NME I*] were in privity with each other." Pet. App. 9. The court recognized that "collateral estoppel is inappropriate where, as here, it would be 'unfair' to the defendant." *Ibid.* (quoting *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 331 (1979)). The court pointed to the fact that the courts of appeals "consistently have denied providers Medicare reimbursement for stock maintenance costs," Pet. App. 10, see *Humana, Inc.* v. *Heckler*, 758 F.2d 696, 700 (D.C. Cir. 1985), cert. denied, 474 U.S. 1055 (1986); *Sun Towers, Inc.* v. *Heckler*, 725 F.2d 315, 317 (5th Cir.), cert. denied, 469 U.S. 823 (1984); *American Medical Int'l, Inc.* v. *Secretary of HEW*, 677 F.2d 118, 124 (D.C. Cir. 1981). Accordingly, the court

concluded that "allowing [petitioner's] subsidiaries in the present case to be reimbursed would unduly privilege them vis-a-vis providers in similar circumstances." Pet. App. 10.

Turning to the merits, the court of appeals held that "the Secretary's decision to deny reimbursement for stock maintenance costs rested on a rational basis." Pet. App. 10. The court found that "[a]lthough stock maintenance programs may influence the corporate form, they have little bearing on its substance, the provision of patient services." *Id.* at 11. The court also noted that "stock maintenance programs are directed primarily at present and future stockholders, rather than at the provision or improvement of patient services." *Ibid.* "Under these conditions," the court concluded, "it was reasonable for the Secretary to deny [petitioner's] subsidiaries reimbursement." *Id.* at 11-12.

ARGUMENT

1. Petitioner contends (Pet. 9-15) that the court of appeals erred in refusing to uphold its claim of collateral estoppel. But the court's rejection of that claim was proper, and presents no question warranting this Court's review.

a. This Court has held that "nonmutual offensive collateral estoppel simply does not apply against the Government in such a way as to preclude relitigation of issues." *United States* v. *Mendoza*, 464 U.S. 154, 162 (1984). Since "this lawsuit is grounded on the claims of [petitioner's] eighteen-wholly owned subsidiaries—fifteen of which were not involved in the prior action," Pet. App. 8, there is no mutuality at least with respect to those 15 subsidiaries.

Nor can petitioner's participation in this action establish the requisite mutuality since it is not a

proper party. This action challenges the Secretary's denial of reimbursements claimed by petitioner's 18 separately incorporated subsidiary hospitals. Under the terms of 42 U.S.C. 1395oo(f)(1), only the "providers of services" to Medicare beneficiaries—the hospitals—"have the right to obtain judicial review of any final decision of the Board, or of any reversal, affirmance, or modification by the Secretary."[4] That statutory provision incorporates the settled principle that a parent firm does not have standing to bring an action as the alter ego of its subsidiaries. See *Schenley Distillers Corp* v. *United States*, 326 U.S. 432, 435 (1946). As the Second Circuit has explained:

> Where a parent corporation desires the legal benefits to be derived from organization of a subsidiary that will function separately and autonomously in the conduct of its own distinct business, the parent must accept the legal consequences, including the inability later to treat the subsidiary as its alter ego because of certain advantages that might thereby be gained. In short, the parent cannot "have it both ways."

In re Beck Industries, Inc., 479 F.2d 410, 418, cert. denied, 414 U.S. 858 (1973). Accordingly, petitioner's attempted sleight of hand in filing as the named plaintiff in the courts below cannot establish the mutuality necessary to invoke collateral estoppel against the government.

b. In any event, collateral estoppel on the basis of *NME I* would be unavailable even if petitioner had

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[4] The statute defines "provider of services" as "a hospital, skilled nursing facility, or home health agency." 42 U.S.C. 1395x(u).

satisfied the element of mutuality.[5] Such preclusive effect is inappropriate where "controlling facts or legal principles have changed significantly since [the prior action]." *Montana* v. *United States*, 440 U.S. 147, 155 (1979). The Court has summarized the basis of this limitation in the context of federal income tax litigation:

> A taxpayer may secure a judicial determination of a particular tax matter, a matter which may recur without substantial variation for some years thereafter. But a subsequent modification of the significant facts or a change in the development in the controlling legal principles may make that determination obsolete or erroneous, at least for future purposes. If such a determination is then perpetuated each succeeding year as to the taxpayer involved in the original litigation, he is accorded a tax treatment different from that given to other taxpayers of the same class. As a result, there are inequalities in the administration of the revenue laws, discriminatory distinctions in tax liability, and a fertile basis for litigious confusion. * * * Such consequences, however, are neither necessitated nor justified by the principle of collateral estoppel. That principle is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static, factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers.

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[5] Thus, the fact that three of petitioner's subsidiaries participated in both *NME I* and the present action does not call for application of collateral estoppel as to their claims for reimbursement.

Commissioner v. *Sunnen*, 333 U.S. 591, 599 (1948); see generally Restatement (Second) of Judgments § 28(2), Comment *c* (1982).

The principle enunciated in *Sunnen* applies with particular force in this case, since petitioner—like the taxpayer in *Sunnen*—is claiming an entitlement to federal funds based on the result of previous litigation. First, there have been significant changes in the pertinent legal landscape since the Court of Claims issued its decision in *AMI-Chanco*, which the Claims Court followed in *NME I*. (See note 2, *supra*.) Congress has divested that court of jurisdiction over Medicare reimbursement claims accruing after June 30, 1973. See note 3, *supra*. Moreover, the decision in *AMI-Chanco*, followed in *NME I*, has not prevailed. The courts that have assumed the jurisdiction previously exercised by the Claims Court have consistently upheld the Secretary's decision to deny reimbursement for stock maintenance costs. See *Humana, Inc.* v. *Heckler*, 758 F.2d 696, 700 (D.C. Cir. 1985), cert. denied, 474 U.S. 1055 (1986); *Sun Towers, Inc.* v. *Heckler*, 725 F.2d 315, 317 (5th Cir.), cert. denied, 469 U.S. 823 (1984); *American Medical Int'l, Inc.* v. *Secretary of HEW*, 677 F.2d 118, 124 (D.C. Cir. 1981).

Second, the changed circumstances preclude application of collateral estoppel in order "to avoid inequitable administration of the laws." Restatement (Second) of Judgments § 28(2), at 273 (1982). In light of the prevailing case law, providers other than petitioner's subsidiaries may not obtain reimbursement for stock maintenance costs. As this Court has recognized, collateral estoppel "is not meant to create vested rights in decisions * * * thereby causing inequities among [similarly situated parties]." *Com-*

missioner v. *Sunnen*, 333 U.S. at 599. To borrow the D.C. Circuit's apt phrasing, "[t]o permit an estoppel here would do exactly that." *American Medical Int'l, Inc.* v. *Secretary of HEW*, 677 F.2d at 124.[6]

2. Petitioner also contends (Pet. 15-21) that the Secretary erred in disallowing its claim for Medicare reimbursement for stock maintenance costs. The governing statute provides Medicare reimbursement only for those costs reasonably "related to patient care," and prohibits reimbursement for costs "found to be unnecessary in the efficient delivery of needed health services." 42 U.S.C. 1395x(v)(1)(A). Under that standard, the Secretary's decision is unexceptionable.

a. Stock maintenance costs, such as those incurred by petitioner, are not sufficiently related to patient care. SEC filings, stock transfers, and stock registrations protect the interests of shareholders; such activities are not meant to benefit patients. Similarly, shareholder meetings and annual reports—by definition—are geared to shareholders and investors. As the D.C. Circuit has recognized:

> [S]tock maintenance costs * * * serve to protect the shareholders and to enhance their investment. While the indirect effect of stock maintenance activities may sometimes benefit medical services, the connection is too indirect.

Humana, Inc. v. *Heckler*, 758 F.2d at 700; accord *Sun Towers, Inc.* v. *Heckler*, 725 F.2d at 328. Accordingly, the Secretary properly determined (Pet. App. 51) that petitioner's hospitals here did not re-

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[6] Petitioner therefore errs in relying (Pet. 11) on *Humana, Inc.* v. *Schweiker*, No. 82-3415 (M.D. Tenn. 1983) (Pet. App. 106-118), since that case did not involve the sort of changed legal circumstances that preclude the application of collateral estoppel.

ceive any patient-care-related benefits as a result of petitioner's incurring stock maintenance costs.

Moreover, stock maintenance costs are not necessary to the efficient provision of needed health care services. Although "[s]tock maintenance costs are necessary for a corporation to exist, * * * medical service can be provided without the corporate form." *American Medical Int'l, Inc.* v. *Secretary of HEW*, 466 F. Supp. 605, 613 (D.D.C. 1979), aff'd, 677 F.2d 118 (D.C. Cir. 1981); accord *Humana, Inc.* v. *Heckler*, 758 F.2d at 700; *Sun Towers, Inc.* v. *Heckler*, 725 F.2d at 327. Patient care services can be—and generally are—provided by hospitals that operate outside the publicly held corporate structure, and thus do not incur stock maintenance costs. In these circumstances, the Secretary properly "found [such costs] to be unnecessary in the efficient delivery of needed health services." 42 U.S.C. 1395x(v)(1)(A).

b. In the face of this straightforward application of the governing statute, petitioner claims (Pet. 16) that the Secretary's policy is irrational because he reimburses those costs incurred to organize a corporate entity. That view is mistaken.

> The primary purpose of all costs incurred at the creation of the entity is to bring into existence a provider of medical services. As the entity survives, the stock maintenance costs have as their primary purpose the protection of stockholder interests in investment. This is a rational distinction justifying the different treatment accorded the different costs by the Secretary.

American Medical Int'l, Inc. v. *Secretary of HEW*, 466 F. Supp. at 615; see *Sun Towers, Inc.* v. *Heckler*, 725 F.2d at 327. Stock maintenance costs, unlike those costs expended to create the corporate entity, generate

no new capital for the corporate owner or provider of health services.

In a similar vein, petitioner points (Pet. 17-18) to the Secretary's policy of reimbursing interest expenses and other costs associated with debt financing. The Secretary reimburses those costs only when the loan is necessary and has a "purpose reasonably related to patient care." 42 C.F.R. 405.419(b)(2)(ii) (1985) (redesignated as 42 C.F.R. 413.153). As explained above, the activities covered by stock maintenance costs fail to measure up to that standard.

c. Petitioner also asserts (Pet. 15-16) that the decision below may not be squared with the Court of Claims' decision in *AMI-Chanco* (followed by the Claims Court in *NME I*). But any such conflict has no current significance, since Congress has divested the Claims Court (and thus the Federal Circuit, successor to the Court of Claims) of jurisdiction over the reimbursement issue. See note 3, *supra*. Accordingly, further review by this Court is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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